

DOCKET SECTION

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D. C. 20268-0001

RECEIVED

JAN 28 4 19 PM '98

POSTAL RATE AND FEE CHANGES, 1997

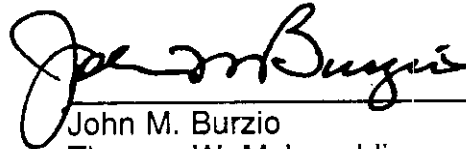
Docket No. R97-1

POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

INTERROGATORIES OF ADVO, INC. TO OFFICE OF CONSUMER
ADVOCATE WITNESS ROGER SHERMAN (ADVO/OCA-T300-1-5)

Pursuant to sections 25 and 26 of the Rules of Practice, Advo, Inc. (Advo) directs the following interrogatories to Office of Consumer Advocate witness Roger Sherman with respect to OCA-T-300.

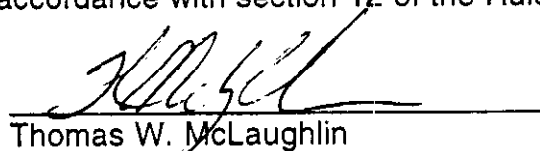
Respectfully submitted,



John M. Burzio
Thomas W. McLaughlin
Burzio & McLaughlin
1054 31st Street, N.W.
Washington, D. C. 20007
Counsel for ADVO, INC.

CERTIFICATE OF SERVICE

I hereby certify that I have on this date served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.


Thomas W. McLaughlin

January 28, 1998

ADVO INTERROGATORIES TO OCA WITNESS SHERMAN (OCA-T-300)

ADVO/OCA-T300-1. On pages 4-5, you state:

"If the Postal Service were to set prices for all mail service subclasses at their marginal costs (represented, say, by accurate volume variable costs), the outcome would be efficient. . . . But a large deficit would result. . . . Such a deficit can be avoided by pricing above marginal cost, but doing so will cause welfare losses. . . . The remarkable property of Ramsey prices is that they minimize the resulting welfare losses."

If postal prices were marked up on the basis of marginal cost (represented by volume variable cost) and then compared to incremental cost, please confirm that the USPS and the Commission could then determine the welfare losses resulting from pricing above marginal cost and could also avoid subsidies between classes and subclasses. If you cannot, please explain why not.

ADVO/OCA-T300-2. Please refer to your discussion at page 38 on Efficient Component Pricing (ECP) which was first applied to telephone company ratemaking. Assume a telephone company faced strong competition for its long-distance service and was facing competition for some of its local service customers as well. Assume also that local service is characterized by scale cost economies. Under that scenario,

- (a) In developing efficient (welfare-loss minimizing) local service prices, would the company and its regulator subsidize long-distance service with higher rates from local service, parts of which face competition? Please explain.
- (b) In developing efficient (welfare-loss minimizing) local service prices, should the company and its regulator consider the cost and demand characteristics of various categories of local customers, specifically including the group of local customers that may be subject to competitive diversion? Please explain.
- (c) Would it be efficient (welfare-loss minimizing) for local service prices to be the same for all local customers, regardless of their cost and demand characteristics? Please explain.
- (d) Would it be efficient (welfare-loss minimizing) for the company to try to increase contribution to common costs from local customers who were most subject to competitive diversion, and to reduce contribution from local customers who were least subject to competitive diversion? Please explain.

ADVO/OCA-T300-3. On page 49, you state: "Worksharing has become a significant factor in postal operations and that makes a Ramsey basis for pricing it a very desirable goal." Do you believe that Ramsey pricing should play a role in developing efficient pricing within a subclass?

ADVO/OCA-T300-4. On page 47, you state: "The Ramsey pricing problem for worksharing might be formulated in different ways. One possible way has been discussed so far, to consider single-piece letters and worksharing letters as two services." In implementing such a system,

- (a) Would you envision explicitly estimating separate Ramsey base and discounted prices? Please explain.
- (b) Would USPS marginal costs be measured separately for each service? Please explain.
- (c) Would the marginal costs for non-workshared and workshared mail be separately marked up to determine base and discounted prices, respectively? Please explain.

ADVO/OCA-T300-5. On page 50, you state:

"As emphasized by Postal Service Witness Panzer (USPS-T-11, p. 41), cost estimates should be based on a Postal Service operating plan, in order to yield consistent results. Of course, this operating plan may not deal with questions that the estimation of incremental cost invites -- such as the actions that would be taken if First Class Mail was eliminated -- because the operating plan does not extend to such possibilities. While intelligent interpretation of the existing cost system may allow reasonable approximations of incremental costs, limitations of the system need also to be recognized. The cost system was not designed to produce incremental cost estimates, and more attention to this purpose is desirable."

Assume that if First Class Mail were eliminated from the system, the remaining system could be restructured to save additional costs beyond those estimated on the basis of the operating plan. Would incremental cost estimates that ignore such system reconfiguration cost reductions be considered long-run incremental costs? Please explain.